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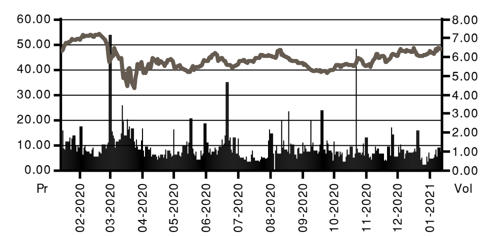
Essential Utilities, Inc.

(NYSE: WTRG)

Rating:	**Neutral**
Price Target:	**N/A**
Price Target Metrics: N/A	
Current Price:	**$48.18**
Float:	244.8MM
Diluted Shares:	254.4MM
Short Interest:	9.8MM
Average Daily Volume:	920k
52 Week Range:	$30.40 - $54.52
Market Cap:	**$12,259MM**
Cash and Investments:	$5MM
Debt:	$5MM
Enterprise Value:	$12,259MM

PRICE & VOLUME CHART



ESTIMATES $ (MMs except multiples & EPS)

	2020 Prior	2020 New	2021 Prior	2021 New	2022 Prior	2022 New	2023
EPS (Diluted)							
Q1 (Mar)	$0.60	$0.60A	$0.62	$0.62E	$0.63	$0.61E	$0.58E
Q2 (Jun)	$0.29	$0.29A	$0.31	$0.30E	$0.30	$0.29E	$0.28E
Q3 (Sep)	$0.23	$0.23A	$0.27	$0.27E	$0.30	$0.30E	$0.33E
Q4 (Dec)	$0.45	$0.45E	$0.46	$0.48E	$0.55	$0.58E	$0.71E
FY	$1.58	$1.58E	$1.66	$1.67E	$1.78	$1.78E	$1.90E
P/E		**30.5x**		**28.9x**		**27.1x**	**25.4x**
Dividends Per Share							
FY	$0.970	$0.970E	$1.038	$1.038E	$1.111	$1.111E	$1.188E
Dividend Yield		**2.0%**		**2.2%**		**2.3%**	**2.5%**

Stock fully valued given market valuations of gas LDCs

Summary:

WTRG's 8.2%/10% water/gas rate base CAGR for 2020-2023 is very impressive, but fully reflected in its current share price, we believe, especially given the ongoing de-rating of gas LDCs, even those with premium rate base/earnings growth prospects. Yesterday, WTRG hosted its 2021 earnings guidance call. The midpoint of its $1.64-1.69 EPS guidance range is in line with consensus expectations.

Highlights

Strong momentum in water/wastewater municipal M&A: WTRG has $420.5MM in pending muni M&A deals on the water/wastewater side, including the $276MM DELCORA transaction which seems likely now that courts have upheld Aqua PA's purchase agreement for the asset. The deals should start boosting WTRG's water earnings in 2022/2023 assuming Aqua PA completes its next water rate case by mid-2022. That's reflected in our model which is based on an 8% water rate base CAGR for 2020-2023. Biden's likely infrastructure spending plan seems unlikely to derail the consolidation of the water/wastewater sector especially in states with the fair value legislation.

De-rating of stocks of gas LDCs: The marginal investor in stocks of US utilities continues to have a strict ESG screen hence the ongoing de-rating of stocks of gas LDCs. Among stand-alone gas LDCs, there is some P/E differentiation between strong (such as ATO or OGS) and weak EPS growers (such as SJI or NJR), but even the premium growers currently trade at a slight 3% discount to an average electric utility on 2023 EPS and at a 46% discount to an average water utility. With an 8-10% rate base CAGR for 2020-2023, WTRG's gas LDC is a fast grower, but that means it deserves to trade at just 16.5x 2023 EPS. A third of WTRG's 2023 EPS should come from gas which is the third highest in our coverage (after ATO and CMS) even after incorporating the DELCORA wastewater transaction.

Tweaking 2021 estimates, adding 2023 estimates: We raised our 2021 EPS estimate to $1.67 from $1.66 to reflect a slightly higher water rate base projection. Our 2022 EPS is unchanged as we added $300MM in equity in 2022 which fully offset the slightly higher water rate base estimate. We introduced our 2023 EPS of $1.90 which also reflects ~ $300MM in equity for that year. That should be enough to fund WTRG's current growth capex assuming the company is able to avoid paying federal cash taxes under Biden's proposed 15% minimum corporate income tax. We don't have PTs for Neutral-rated stocks, but to us, WTRG's current market valuation fully reflects its premium water/gas EPS growth prospects.

Company Description:

WTRG owns and operates water utilities (1 million accounts) and gas utilities (0.74 million accounts) in 10 states though mainly PA.

SEE ANALYST CERTIFICATION AND OTHER IMPORTANT DISCLOSURES ON PAGES 4 - 6 OF THIS REPORT.

WTRG: EPS breakdown by segment ($)

WTRG	2019A	2020E	2021E	2022E	2022E	20-'23 CAGR
Regulated water utilities	1.47	1.10	1.15	1.25	1.31	
Regulated gas utilities	0.00	0.54	0.63	0.69	0.74	
Parent	0.00	-0.06	-0.12	-0.16	-0.15	
Total EPS	**1.47**	**1.58**	**1.67**	**1.78**	**1.90**	**6.4%**
DPS	**0.91**	**0.97**	**1.04**	**1.11**	**1.20**	**7.2%**
Dividend payout	62%	61%	62%	62%	63%	

Source: Company data for 2019; Seaport Global Securities

WTRG	2019A	2020E	2021E	2022E	2023E
Operational EBITDA	505	874	928	1,018	1,070
Operational EBIT	349	610	647	713	747
Net interest expense	100	202	210	233	223
Ordinary Profit Before Tax	269	437	466	512	559
Income tax	7	35	37	41	45
Net profit	262	402	429	471	515
S/O (m)	178	255	258	265	271
Diluted EPS	**1.47**	**1.58**	**1.67**	**1.78**	**1.90**
DPS	**0.91**	**0.97**	**1.04**	**1.11**	**1.20**
Cash	1,869	5	5	5	5
Receivables	108	110	113	121	126
Inventory	18	30	30	30	31
Other short-term assets	18	18	18	18	18
Other-long term assets	1,003	3,810	3,810	3,810	3,811
Property, plant, and equipment	6,346	9,081	9,659	9,929	10,181
Total assets	**9,362**	**13,054**	**13,635**	**13,913**	**14,172**
Financial liabilities	117	496	496	496	496
Operating liabilities	67	109	108	108	111
Other liabilities	108	220	220	220	220
Deferred credits	2,057	2,758	2,757	2,757	2,756
Long-term debt	2,943	4,750	5,619	5,769	5,932
Shareholders' equity	4,070	4,721	4,434	4,563	4,656
Total liabilities and equity	**9,362**	**13,054**	**13,635**	**13,913**	**14,172**
Net income	262	402	429	471	515
D&A, goodwill amortisation	156	264	281	305	323
Other non cash elements	-40	-6	-6	-6	-4
Funds from operations	379	660	704	769	833
Non-cash working capital	-40	43	-1	0	3
CFO	**339**	**703**	**703**	**769**	**836**
Net investments in fixed assets	-610	-6,675	-1,309	-925	-975
Net investments in financial assets	6	0	0	0	0
Free cash flow before dividends	**-266**	**-5,972**	**-606**	**-156**	**-139**
Dividends paid	-161	-242	-266	-293	-323
Free cash flow after dividends	-427	-6,214	-872	-449	-461
Changes in equity	1,935	302	2	298	298
Changes in financial debt	386	4,047	869	150	163
Adjustment for minorities / miscellaneous	-28	1	1	1	1
Increase in cash	1,866	-1,864	0	0	0

Essential Utilities, Inc. (WTRG) Disclosures

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Risks & Considerations for Essential Utilities, Inc. (WTRG)

Allowed ROEs for WTRG's regulated utilities could fall due to lower market interest rates: Equity returns/ROE of regulated electric/gas/water utilities are indirectly linked to the 10-year Treasury yield. The average allowed ROE of a regulated utility in the US dropped just 25 bps since 2008 despite a 152 bps drop in the average 10-year T yield over this period. However, state utility regulators could sharply reduce allowed ROEs of regulated utilities going forward which currently average 9.75% average. The allowed ROE together with an equity ratio are the key drivers of regulated utility earnings. WTRG's only pending rate case (in NC) is very small.

Lower sales volumes could weigh on WTRG's realized ROEs and thus earnings: A utility can see a meaningful deficiency between its realized and allowed ROE depending on the level of sales volumes and operating expenses. While the latter can be controlled, sharp reductions in sales volumes due to energy efficiency (residential and commercial sales) or closure of industrial facilities. The latter is particularly pronounced during the COVID pandemic. The sharply lower C&I sales volumes could weigh on utility earnings beyond 2020. While rate cases could true up sales volume assumptions, utilities could delay rate filings because their ROE could be reduced during those proceedings on the back of sharply lower interest rates.

Rate case outcomes are hard to predict: While regulated utilities are allowed to recover prudently incurred costs, it's up to state utility regulators to determine which costs are in fact recoverable and the return on regulated assets. Some rate case requesting higher revenues may end with a reduction in authorized rates thus revenues and thus earnings. WTRG's regulatory calendar is quiet in 2020, with a pending small rate case in NC, and a likely filing for a catch-up repair tax adjustment for Peoples in PA.

Gas utilities have a higher operating risk than water utilities: Over-pressurized gas systems seem to happen more frequently among gas utilities in the US. While we recognize that Peoples Gas is a well-managed system, WTRG's risk profile could further deteriorate with any gas-related operational issues. Additionally, investors increasingly scrutinize the carbon footprint of gas LDCs which in turn weighs on their market valuations.

Risks & Considerations for Atmos Energy Corp. Atmos Energy Corp. (ATO)

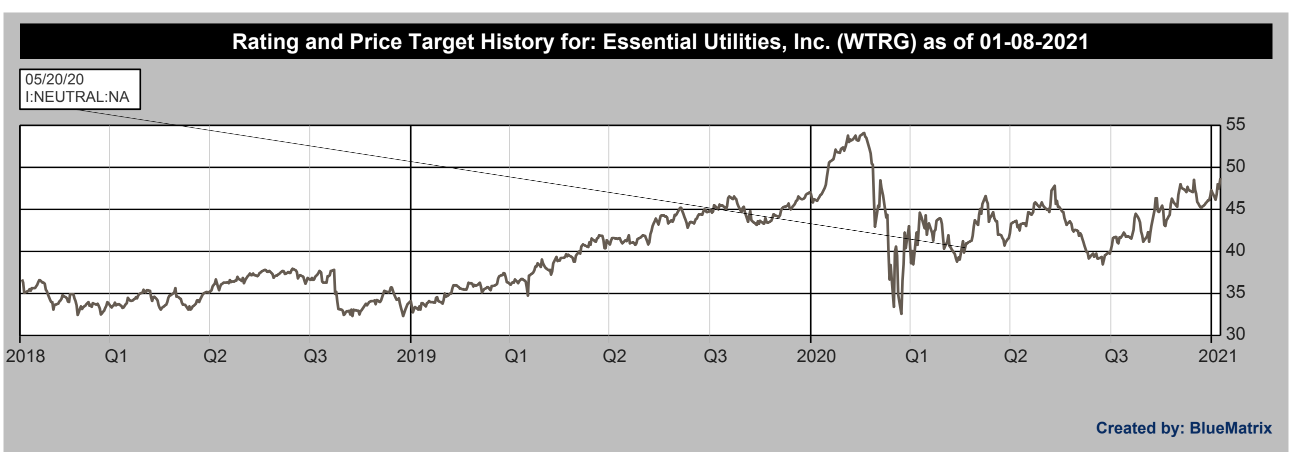
Allowed ROEs for ATO's gas LDCs and pipeline could fall due to lower market interest rates: Equity returns/ROE of regulated electric/gas/water utilities are indirectly linked to the 10-year Treasury yield. The average allowed ROE of a regulated utility in the US dropped just 25 bps since 2008 despite a 152 bps drop in the average 10-year T yield over this period. However, state utility regulators could sharply reduce allowed ROEs of regulated utilities going forward which currently average 9.75% average. The allowed ROE together with an equity ratio are the key drivers of regulated utility earnings. ATO's gas LDCs and its pipeline have above-average allowed ROEs and equity ratios especially when compared to regulated electric utilities in TX. Future rate reviews could lead to lower allowed ROEs though cheap natural gas prices are supportive of premium returns for ATO's assets.

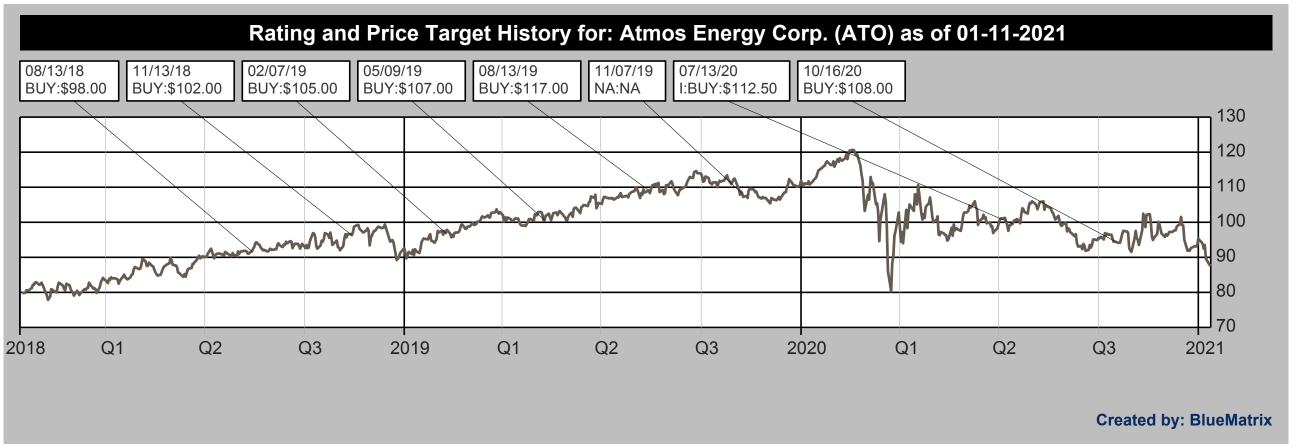
Rate case outcomes are hard to predict: While regulated utilities are allowed to recover prudently incurred costs, it's up to state utility regulators to determine which costs are in fact recoverable and the return on regulated assets. Some rate case requesting higher revenues may end with a reduction in authorized rates thus revenues and thus earnings.

Gas distribution and transmission systems have a higher operating risk than electric systems: Overpressurized gas distribution pipes have led to explosions and severe regulatory repercussions especially in California and the Northeast. While ATO was not involved in any of these accidents and the company operates in very constructive regulatory regimes, we still see some elevated operating risk vs. an average regulatory utility we cover.

Other Companies Mentioned in This Report

- Atmos Energy Corp. (ATO: $87.67, Buy)
- New Jersey Resources Corp. (NJR: $35.78)
- ONE Gas Inc. (OGS: $71.92)
- South Jersey Industries Inc. (SJI: $21.86)





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Sell - The investment outlook and risk/reward over the following 12 months are unfavorable on an absolute basis and relative to the peer group.
NA - A rating is not assigned.

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Accumulate - The investment outlook and risk/reward over the following 12 months are favorable on an absolute basis and relative to the peer group.
Neutral - The investment outlook and risk/reward over the following 12 months are neutral on an absolute basis and relative to the peer group.
Reduce - The investment outlook and risk/reward over the following 12 months are unfavorable on an absolute basis and relative to the peer group.
Sell - The investment outlook and risk/reward over the following 12 months are very unfavorable on an absolute basis and relative to the peer group.
NA - A rating is not assigned.

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	Research Coverage		Investment Banking Clients*		
Rating	Count	% of Total	Count	% of Total	% of Rating Category
Buy	124	63.9%	2	100.0%	1.6%
Neutral	68	35.1%	0	0.0%	0.0%
Sell	2	1.0%	0	0.0%	0.0%
Total	194	100.0%	2	100.0%	1.0%

*Investment banking clients are companies for whom Seaport Global Securities has provided investment banking services in the previous 12 months.

Note: Ratings Distribution as of December 31, 2020

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